No. 14400

IN THE

United States Court of Appeals

For the Ninth Circuit

1954 TERM

UNITED PRODUCERS and CONSUMERS CO-OPERATIVE, a Corporation, and SOUTHWEST CO-OPERATIVE WHOLESALE, a Corporation,

Appellants,

vs.

RALPH W. HELD,

Appellee.

Appeal from the United States District Court for the District of Arizona

REPLY BRIEF OF APPELLANTS

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APPELLANTS' REPLY BRIEF

Appeal from the United States District Court
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Reply to Appellee's Contention That a Contract for a Three-Year Term Is Not Prohibited by the By-Laws

Appellee in his brief on this point contends: that the by-laws did not prohibit the employment of a manager; that the recent trend of authority is contrary to holding a contract void if it is in conflict with the by-laws; that the by-laws were nothing more than rules of conduct adopted by the directors or

members for the efficient handling of business affairs; and, lastly, that recent statutes in other jurisdictions provide that, although corporations shall have the power to remove officers, they shall be liable in damages for wrongful removal.

For fear of being repetitious, which we will make every attempt to avoid, we should like to point out to the Court that the Cooperative Marketing Statute of Arizona which has been referred to in both briefs, devotes a great deal of attention to the by-laws of a cooperative marketing corporation. The general corporation law of Arizona merely states under "Grant of Powers," Section 53-204, Arizona Code Annotated, 1939, that the corporation has the power to establish by-laws and make the rules and regulations deemed expedient for the management of its affairs not inconsistent with the law. The Cooperative Marketing Statute, on the other hand, lays great stress upon by-laws; for example, the corporation may admit as members certain persons under the terms and conditions prescribed in its by-laws. Section 49-703, Arizona Code Annotated, 1939.

It is provided in the next section that the property rights of the members shall not be altered, amended or appealed except by the written consent or vote of three-fourths of the membrs qualified to vote under the by-laws of the association. Section 49-704, Arizona Code Annotated, 1939.

The most important section, Section 49-706, Arizona Code Annotated, 1939, states, as we previously set forth in Appellants' Brief, that each association within thirty days after its incorporation *shall* adopt by-laws and that a majority vote of the members, or their written assent, is necessary to adopt such by-laws, and sets forth many things that the by-laws may provide for, including duties and terms of office of directors and officers. The last paragraph of this section, Section 49-706 Arizona Code Annotated, 1939, states that at the termination of each contract period, the association may renew or revise the by-laws to be

in effect for the next contract period, and after such renewal or revision, the by-laws *shall* be the by-laws of the association unless objections are made thereto by fifty per cent of the members.

Section 49-707, Arizona Code Annotated, 1939, sets forth that the by-laws shall provide for one or more regular meetings and sets forth how the meetings are to be called, stating that the by-laws may require such notice to be given by publication in a newspaper.

Section 49-708, Arizona Code Annotated, 1939, provides that the by-laws may provide the manner in which the directors are to be elected, and how vacancies may be filled.

Thus, the Cooperative Marketing Act of Arizona deals with the by-laws of the association to a greater extent than it does with the Articles of Incorporation, indicating that, contrary to Appellee's contention, the by-laws are not mere rules of conduct adopted by the directors or the members themselves for the efficient handling of the business affairs of the corporation. (p. 10—Appellee's Brief.)

The cases cited by Appellee under Part I of his argument relating to this question all deal with cases where the board of directors had the unquestioned power to amend the by-laws. In the case of *Hill v. American Cooperative Assoc.,* 195 La. 590, 197 So. 241 (1940), cited by Appellee on page 10 of his Brief, the Court points out that the defendant in that case cited the case of *Hunter v. Sun Mut. Ins. Co. of New Orleans,* 26 La. Ann. 13, and *Fowler vs. Great So. Tel. Co.,* 104 La. 751, 29 So. 271, and of these cases and the defendant's contention in the instant case, the Court said:

> "The cited cases are not pertinent because in those cases the board of directors did not have authority to alter the by-laws adopted by the stockholders."

We submit that the public policy of the State of Arizona, as set forth in the Cooperative Marketing Statute and the Statute itself, limits the right of the board of directors to amend the by-laws. We cannot help but repeat the requirement for the adoption of by-laws as is set forth in the Arizona Statute, which provides that the by-laws *must* be adopted by a majority of the members or their written assent. This is certainly contrary to the usual corporate practice wherein the board of directors alone adopts the by-laws. The reason for the distinction is to us obvious in that a cooperative association made up of members is a non-profit corporation, strictly for the benefit of its members and the directors have no greater powers than do the elective officials of a municipal corporation, for it is their purpose and duty to serve the members. It is not a profit-making organization.

Appellee contends that Southwest Co-Operative Wholesale is not a cooperative marketing association, and points out one section of the Cooperative Marketing Act which states that five or more persons engaged in the production of agricultural products *may* form a non-profit cooperative association without capital stock. Thus, Appellee contends that since there is stock set up in Southwest Co-Operative Wholesale, it is not a cooperative under the Arizona Act.

Let us look further at the Articles of Incorporation of Southwest Co-Operative Wholesale (Defendants' G in evidence) which recite the purpose for which the corporation is organized in Article II. Section (1) of Article II is practically verbatim with the second paragraph of Section 49-702, Artizona Code Annotated, 1939, setting forth the powers of a cooperative marketing association. All of the sections under Article II deal with cooperative purposes. Particularly note Section (10) of Article II, whereby they have the power to enter into contracts with farmers and agricultural producers for the handling, preparing for market and marketing.

Referring to Section 49-702, Arizona Code Annotated, 1939, the statute reads in part as follows:

> "To acquire and to hold, own and exercise all rights of ownership in, and to sell, transfer, or pledge shares of *the* capital stock or bonds . . . " (Emphasis ours.)

Also a portion of the same statute reads:

> "To establish reserves and to invest the funds thereof in stocks and bonds of any corporation or association engaged in any related activity, or in the handling, marketing, processing or financing of the products handled by the association . . . "

And then the last paragraph of the aforesaid section states:

> "To possess the powers, right and privileges of corporations organized under the general laws of the state, unless inconsistent herewith."

Section 49-710, Arizona Code Annotated, 1939, states as follows:

> "When a member of an association established without capital stock, has paid his membership fee, he may receive a certificate of membership. Members shall not be liable for the debts of the association above the sum remaining unpaid on their membership fees. No member shall be entitled to more than one (1) vote."

This section would indicate that if there is no stock, the member is to receive a certificate of membership; corollary, of course, if there is stock, he would receive stock.

The most important section which begins to spell out the entire purpose and recitation of the fact that there can be stock or memberships in a cooperative marketing association is Section 49-712, Arizona Code Annotated, 1939, under Referendum, which states as follows:

"Upon demand of one-half of the entire board of directors, any matter that has been approved or passed by the board must be referred to the membership or the stockholders for decision at the next special or regular meeting."

In concluding this matter, Section 49-717, Arizona Code Annotated, 1939, states as follows:

"An association organized hereunder may organize, form, operate, own, control, have an interest in, own stock of, or be a member of any other corporation, with or without capital stock, engaged in processing, handling, utilizing, manufacturing, marketing, financing or selling of the agricultural products handled by the association, or the by-products thereof. Profits or income received from the foregoing investments may be added to the reserves of the association, to be distributed or handled according to the discretion of the board of directors. It may enter into contracts and arrangements with any other cooperative corporation, or association, formed in this or in any other state, for the cooperative and more economical carrying on of its business, or any part thereof. Any two (2) or more associations may, by agreement between them, unite in employing and using the same methods, means and agencies for carrying on and conducting their businesses."

This indicates that the association or corporation organized under this Act may own stock or be a member of any other corporation, with or without capital stock, engaged in the same type of business.

Thus, we see in view of the Articles of Incorporation of Southwest Co-Operative Wholesale and the statutes above referred to that Southwest Co-Operative Wholesale is controlled by and operating under the Cooperative Marketing Act of Arizone. It is true that the Articles of Incorporation do not specifically state that it is organized under that Section. If, however, the Articles of Incorporation and the activities of the corporation are such that, we contend, it certainly is a cooperative association. If Southwest is not a cooperative marketing association, and therefore the same impediment as to the amend-

ment of the by-laws does not apply, the record shows that the margin of United was greater than the margin of Southwest (Plaintiff's Exhibit 9) and, since the by-laws did not allow this type of contract for United, United should not be penalized, and some determination would have to be made as to what percentage Southwest would be forced to pay if the Plaintiff was successful in all of his other arguments and unsuccessful in this one.

The Appellee further contends that the contract period referred to in Section 49-706, Arizona Code Annotated, 1939, relates only to a marketing contract set forth in Section 49-713, Arizona Code Annotated, 1939. In this we cannot agree. It is well known that there are several types of cooperatives, strictly speaking. One is an organization whereby members get the benefit of increased purchasing power and savings by cooperating together through one association. Certainly a considerable portion of United's business was this type of cooperative. Thus, the contract referred to in the record (pp. 190-191) is that type of a contract which extends specifically for one year. Therefore, it is the contention of Appellants that the by-laws could not be changed in the interim. It appears that it is just as important that the by-laws in that type of a marketing contract be contstant and subject to the scrutiny and control of the members as in any other type of cooperative arrangement.

Thus, it is the contention of Appellants that the by-laws were more than mere rules of conduct and it has been conclusively shown that the Plaintiff-Appellee had knowledge that the by-laws provided that he hold office at the pleasure of the board of directors.

II.

Reply to Appellee's Contention That Employment of a Manager Beyond the Term of the Then Board Members Is Not Void.

Appellee attempts to pass over the Arizona case cited by Appellant, *Tucson Fed. Sav. & Loan Ass'n v. Aetna Inv. Corp.,* 74 Ariz. 163, 245 P. 2d 423, with the mere statement that that case holds that employment contracts were not in point in the issue before the Arizona court.

Let us examine the history of Arizona cases dealing with this subject. These cases deal with municipal corporations.

The first of such cases in the case of *Town of Tempe vs. Corbell,* 17 Ariz. 1, 147 P. 745. In that case, the town Council had attempted to employ a party as a street sprinkler for a period beyond the term of the Council and the Court in that case, after stating that the general rule is that a contract made by the commissioners in good faith is ordinarily a valid contract, stated as follows:

> "A well-recognized exception to the rule exists applicable to contracts in reference to matters which are personal to the board in their nature, and the contract limits the power of the succeeding members to exercise a discretion in the performance of a duty owing to the public. This exception to the rule is based upon the grounds of public policy."

The next Arizona case on the subject arose in 1922 in the case of *Olmsted & Gillelen v. Hesla,* 24 Ariz. 546, 211 P. 589. In this case, there was a contract of employment of engineers for the County Highway Commission under a bond issue. The terms of the Highway Commissioners expired three months after the date of the contract; however, the construction could not be completed in less than three years. The Court, after stating that although the Commissioners themselves might not have the professional skill and knowledge to do some of the work they were nevertheless responsible to the County for the work, stated:

> "Since that must be true, we think the commission that is in office while construction or improvement is being done should

be allowed to select its own employees and servants, and that such is the intent and policy of the road improvement acts. Otherwise an incoming commission might be burdened with a corps of employees and servants unwilling or unfit to do the work, yet made responsible for their acts in connection with the work in hand."

Perhaps the clearest statement is set forth in the case of *Pima County vs. Grossetta,* 54 Ariz., 530, 97 P. 2d 538, and in this case, the Board of Supervisors in Pima County had hired three groups of practicing attorneys to do three things: first, to sue to recover a jury fee judgment; second, to prosecute a certain civil case in which the County was interested; and third, to sue a local bank for taxes the County believed to be due. Concerning this, the Court stated the rule as follows:

"The first is whether the contracts were ultra vires for the reason that they extended beyond the term of the existing board of supervisors and that of the county attorney who consented thereto. We have had a similar question under consideration in Town of Tempe v. Corbell, 17 Ariz. 1, 147 P. 745, L.R.A. 1915E, 581, and Olmsted & Gillelen v. Hesla, 24 Ariz. 546, 211 P. 589. At first glance it might seem that the opinions therein supported the objection under consideration, but a careful examination will show that the true rule laid down may be stated as follows: Where the contract in question is a unitary one for the doing of a particular and specified act, but its performance may extend beyond the term of the officers making it, if it appears that the contract was made in good faith and in the public interest it is not void because it will not be completed during the term of those officers. *If, on the other hand, the contract is for the performance of personal or professional services for the employing officers, their successors must be allowed to choose for themselves those persons on whose honesty, skill and ability they must rely."* (Emphasis ours.)

Thus the rule that Appellee refers to as dicta in Tucson Fed. Sav. & Loan Ass'n. v. Aetna Inv. Corp., supra, is not new in this jurisdiction. In the case before the Court, the contract was for

the services of a general manager. Section 49-708, Arizona Code Annotated, 1939, states in part as follows:

> "The affairs of the association shall be managed by the board of directors, elected by the members from their number."

In this direction of the Statute, it states that the affairs shall be managed by the directors. Thus, the directors are personally responsible for the management. Therefore, they can not turn over control to a third party, as was done in this case. Certainly the hiring and firing of *all* persons needed to carry on the affairs of the business is an integral part of the management of the affairs of the business, and this was given by the board to Held, and was to extend beyond the terms of all of the then board members of both corporation.

We submit, therefore, that under the authority previously cited and under the analogous authority of Arizona Courts in previous cases, this contract was absolutely void for the reason that it extended beyond the term of the then directors. In this regard, we should like to point out that although we are not specifically setting up a heading in answer to other parts of Appellee's Brief, this reasoning makes us feel that our argument previously advanced as to the necessities and desirability of Walmsley's supervision in working out the terms was something that the Board bargained for in view of the fact that Walmsley, upon questioning of Appellee, stated that he would not have agreed to a contract for a three-year term.

Appellee attempts to belittle the case of *Edwards v. Keller,* 133 SW 2d 823 (p. 22 Appellants' Brief) by saying that the case is not in point because it is under a Texas statute. That particular Texas statute merely provided for the election of directors annually at the annual meeting of the stockholders. Our statute provides that the by-laws shall set forth the terms of office of the directors, and the by-laws of United provide that the directors

shall be elected at the regular annual meeting, and the by-laws of Southwest provide for a three-year election and set forth the usual staggered term provision. Thus, the Texas Statute upon which Appellee lays so much stress to get around the decision in that case, is merely that directors are elected for specific terms, which is true in this case also.

The Edwards vs. Keller case, supra, holding was followed in the more recent case of *Leon Farms Corp. v. Beaman,* 240 SW 2d 433.

Summary of Argument

Appellants have replied to argument of Appellee as to the vital points of the issues on appeal. We feel that the previous argument on the other points amply sets forth the issues of both parties and, because of the time and space limitation, we have devoted no further argument to those points.

It is respectfully submitted by Appellants that this contract is void on two basic principles:

First, that the board of directors did not have authority to enter into the contract. This is prefaced upon the Statute of Arizona, the public policy of the State, and the fact that the Plaintiff-Appellee had personal knowledge of the prohibitions.

Second, that the contract is void, inasmuch as it was a contract for services that should have been performed by the board members and that it tied the hands of subsequent boards. The contract, therefore, is against public policy and contrary to decisions of the State of Arizona.

It is the further contention, as set forth in Appellants' opening brief, that the terms of the resolutions required Smith and Walm-

sley to employ plaintiff and that Walmsley did not sign the agreement and would not have agreed to the terms.

It is the further contention, as previously set forth, that "net income" does not mean "net margin," a fact well known by Plaintiff-Appellee.

Conclusion

It is submitted that the judgment of the District Court should be vacated and reversed, with direction to enter judgment for the Defendants, as prayed.

Respectfully submitted:

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